The Economic Insight

Economic Analysis and Forecasting Division
February 18, 2022

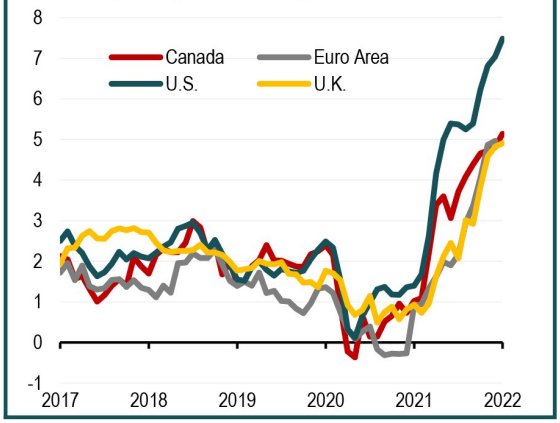
Themes of the Week

- **CANADA.** Consumer price inflation surprised the market on the upside in January – reaching the highest rate since September 1991 – and is expected to rise further next month. Meanwhile, the latest data for 2021Q4 continued to point to a strong pace in the quarter, which will be confirmed in the March 1st release of the National Accounts. While Omicron's severe impact on the labour market in January suggested the recovery is likely to see its first monthly contraction since May, the slowdown is widely expected to be short-lived, with losses expected to be quickly recouped in February and March. Indeed, real-time data indicate a resurgence in consumer activity since late January, and further improvements are expected in the coming weeks as several provinces laid out plans for a rapid roll-back of public health restrictions. At the same time, January saw increasingly tight housing market conditions and an acceleration in price growth, possibly reflecting prospective buyers trying to get into the market ahead of looming rate hikes that could come as soon as the Bank of Canada's March 2nd announcement.
- **GLOBAL**. This week in the United States, the January minutes show the FOMC is ready to move quickly, but provided no clear signal for a 50-basis point hike in March. In addition, U.S. shoppers spent more at the start of the year as the Omicron wave started to recede and consumers absorbed a four-decade increase in prices. In the United Kingdom, inflation has risen at the fastest pace in almost 30 years. The combination of stronger-than-expected GDP data, solid wage gains and an upside inflation surprise could bring the Bank of England to consider a larger-than-usual rate hike in March. In China, factory-gate inflation eased and consumer price growth slowed, giving monetary and fiscal authorities room to stimulate economic growth at a time when more major economies are looking to tighten policies to curb rising prices. In Japan, real GDP returned to growth in the fourth quarter of 2021 thanks to higher consumer spending, but a resurgence in COVID-19 infections is set to hold back the recovery in the first quarter of the year.

Canadian Developments

Chart of the Week:

CPI inflation's strong start to 2022



- **Consumer price inflation continued to heat up in January**—consistent with the experience in other advanced economies (see *Chart of the Week*). Headline inflation rose to a 31-year high of 5.1%, up from 4.8% in December and well above market expectations for a flat reading. The acceleration reflected a solid 0.6% monthly gain and a notable broadening of inflationary pressures, with all three of the Bank of Canada's core inflation metrics up 0.2 percentage points. Most forecasters do not expect relief in the near term, with a further acceleration likely in February and March as unfavourable base-year effects, strong demand conditions, and hot housing and commodity markets keep a floor under inflation. Further ahead, forecasters still expect gradual easing over the rest of the year, with inflation remaining above the Bank of Canada's 1-3% target range by year end. However, the outlook for is uncertain with risks largely tilted to the upside, including the potential for an acceleration wage growth, higher energy prices, and further home price gains.
- On March 1, Statistics Canada will release the widely-anticipated 2021Q4 National Accounts and December GDP. We are **currently tracking real GDP growth of 6.1% (annual rate) in 2021Q4,**

matching the February 2022 survey but above the 5.1% increase expected at the time of the Economic and Fiscal Update (EFU). While forecasts are slightly below the 6.4% growth implied by the flash estimate for December GDP, they are consistent with the typical gap between the quarterly and monthly reports (±0.6 percentage point). Growth in the quarter is expected to be broad-based, led by an ongoing recovery in close-contact services, a hotter resale market, government spending, and solid growth in exports and inventories (partly reflecting a rebound in auto manufacturing). At the same time, we expect **GDP inflation to reach 6.5% (annual rate) in 2021Q4—**well above the February 2022 survey and the EFU (4.2% and 3.0%, respectively). Given the strength in commodity prices and home prices so far this year, elevated GDP inflation is expected to continue into 2022Q1 (tracking at 6.1%), though some of the gains could prove temporary if commodity prices soften later in the year.

- Although Omicron dragged somewhat on the economy in December, as illustrated by the December's weak reading for retail sales, it is not expected to feature prominently until 2022Q1 since most restrictions were not imposed until late December or early January. As always, December GDP will be accompanied by a flash estimate for January, which will shed light on the extent to which Omicron-related restrictions and absenteeism hampered production in the month. Further ahead, February will see significantly less drag from Omicron with further improvement expected in March—setting the stage for a turnaround in growth and jobs. Indeed, real-time data suggest consumer activity has been on the upswing since late January, while EI claims have swiftly fallen back to normal levels. Recently announced plans for a rapid roll-back of public health restrictions (capacity limits, proof-of-vaccination requirements, international travel, etc.) should provide further support to activity in the coming months.
- Overall, we expect **real GDP growth to decelerate sharply to 1.4% (annual rate) in 2022Q1 as Omicron takes a toll on the economy**—up slightly from our previous call of 1.1%. A big upside surprise for January retail sales (flash estimate pointing to a 2.4% *increase*), as well as the continued strength in housing activity in the month, should partly offset weakness in close-contact sectors and lead to a smaller contraction in January than we previously thought. At the same time, while blockades associated with the so-called "Freedom Convoy" protests is weighing on output in certain sectors in February (e.g., autos), the GDP impact is expected to be temporary and modest (about 0.1–0.2%), and should not prevent a solid growth pace in February.
- On March 2, the Bank of Canada will decide whether to raise its policy rate for the first time since 2018. **Markets are fully pricing in a rate hike at the upcoming announcement with a total of 6 hikes expected in 2022.** While private-sector economists are in consensus that the Bank will raise its policy rate in two weeks, there is disagreement on how many 25 basis-point hikes to expect this year (ranges from 3 to 7) and how high rates will be by the end of 2023 (ranges from 1.5% to 2.5%). A key question for policymakers is how quickly and to what extent monetary tightening impacts Canada's red-hot housing market – which lurched deeper into sellers' market territory and saw further price gains in January – and the degree of easing in the broader economy.

Global Developments

- In the United States, **the January FOMC meeting minutes showed "most" on the committee are willing to remove accommodation more quickly than they had previously anticipated if inflation fails to move down as expected.** Economic data in the interim suggest participants are more likely coalescing around six or seven 25 basis point hikes this year, more than the two or three expected in December. There was no clear indication of a 50 basis point move in March. On the data side, **U.S. nominal retail sales jumped 3.8% in January, far more than market expectations (+2.0%), following a 2.5% decline.** The details point to solid consumer demand for

durable goods such as autos and furniture. That said, only a partial rebound from the previous months' sharp declines in discretionary categories such as electronics and clothing, as well as falling sales of sporting goods, hint at a broader slowdown in spending as the year progresses, particularly if energy inflation accelerates. Looking forward, with growth in disposable income back to its pre-recession trend as most pandemic-era stimulus payments have ended, retail spending should normalize to lower, more sustainable levels over the year.

- United Kingdom inflation unexpectedly accelerated for a fourth consecutive month in January. **Prices grew 5.5% (y/y), a new three-decade high, driven by clothing and footwear. Both economists and the Bank of England (BOE) had expected inflation to remain unchanged at 5.4%.** An index that excludes volatile items quickened to a record 4.4%. The report raises the stakes for the BOE, as financial markets see a 50% probability of a 50 basis-point interest rate increase in March, an unprecedented move since it gained independence in 1997. The central bank is expecting inflation will peak at around 7.3% in April, more than triple its 2% inflation target, when a surge in energy costs is set to arrive at the same time as a planned payroll tax hike.
- In China, January's cooling inflation suggests the moderating price trend will extend into 2022. It is likely to give the central bank more scope to ease its monetary policy further in the face of economic headwinds. **Consumer price inflation slowed, dropping to 0.9% (y/y) from 1.5% in December.** Steeper falls in food prices, which declined 3.8% from a year earlier, capped gains in the overall index. Food costs dropped just 1.2% in December. In addition, **producer price inflation also slowed for a third straight month, decelerating to a 9.1% (y/y) pace from 10.3% a month earlier.** The January slowdown reflected more moderate gains in prices for major commodities such as steel and coal. Moreover, **this week the People's Bank of China (PBOC) left the medium lending facility rate unchanged at 2.85%, in line with market expectations.** The medium lending facility rate sets the base for banks' loan prime rates, the reference rates for corporate and mortgage loans. That said, the central bank has signaled it is willing to do more to support growth. In the near term, the PBOC is expected to use additional policy tools in the easing effort, such as further reductions in reserve requirements and steps to spur credit expansion.
- Japan's economy returned to growth in 2021Q4, fueled by the strength of consumer spending that is now threatened by the latest omicron wave. Business investment and exports also contributed to the expansion as supply chain blockages eased and the worst of the virus's delta wave passed. Therefore, **real GDP rose 5.4% in 2021Q4 (QAAR) following a decline of 2.7% the quarter prior, below expectations of a 5.7% gain.** The fourth quarter growth was supposed to be the start of a more durable rebound for Japan as it struggles to catch up with the pandemic recoveries of the other G7 countries. But record cases of the virus at the start of 2022 and renewed restrictions on businesses have raised the prospect of yet another imminent contraction.

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Upcoming Events and Data Releases

Canada	International
• 2021Q4 National Economic Accounts and December GDP (*Mar 1*) • Bank of Canada rate announcement (*Mar 2*) • February Labour Force Survey (*Mar 11*) • February Consumer Price Index (*Mar 16*)	• U.S. Employment Report *(Mar 4)* • OECD Economic Outlook *(Mar 8)* • U.S. Consumer Price Index *(Mar 10)* • European Central Bank meeting *(Mar 10)* • FOMC meeting *(Mar 16)* • Bank of England meeting *(Mar 17)*

Latest Economic Forecasts: Canada and United States

per cent, period to period at annual rates

	2021Q2	2021Q3	2021Q4	2022Q1	2021	2022
Real GDP growth						
Economic and Fiscal Update 2021	-3.2	5.4	5.1	4.8	4.6	4.2
February 2022 Survey [NOT PUBLIC]	-3.2	5.4	6.1	1.0	4.6	3.8
Internal Monitoring	-3.2	5.4	6.1	1.4	4.6	3.8
Internal Nowcasting	-3.2	5.4	6.1	1.1	4.6	-
U.S. Real GDP Growth						
Economic and Fiscal Update 2021	6.7	2.0	4.5	4.1	5.6	3.9
February 2022 Survey [NOT PUBLIC]	6.7	2.3	6.4	2.2	5.7	3.8
Blue Chip Average	6.7	2.3	6.9	1.8	5.7	3.7
Internal Monitoring	6.7	2.3	7.2	2.0	5.7	-

Note: Shaded area are actuals at the time of the forecast. As of February 18, 2021.

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Canadian Data This Week

Consumer Price Index – January 2022

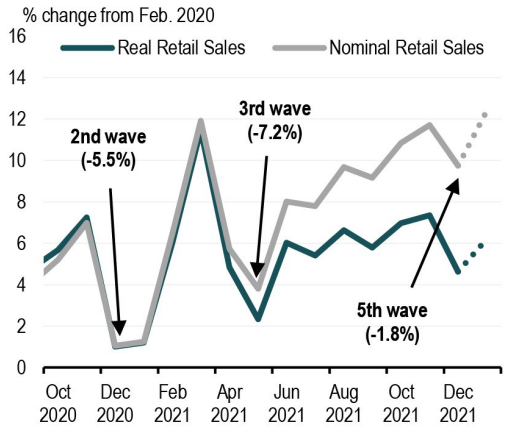
- **Inflation continued to heat up in January,** rising to 5.1% (year-over-over) from 4.8% in December. Month-over-month inflation accelerated to 0.6% from 0.3% last month, reflecting broad-based price gains. With the broadening of inflationary pressures, all three of the Bank of Canada's measures of core inflation rose in January, and now range from 2.3% to 4.0%.
- The **report supports our view that inflation will remain elevated in the near term**. Inflation is likely to rise further in February and March due to strong underlying pressures and unfavourable base-year effects. Further ahead, goods and energy inflation should ease as supply-demand dynamics improve, which should bring headline inflation closer to the top of the target range by the end of 2022.

CPI Inflation

Retail Trade – December 2021

- **Retail sales fell 1.8% in December (slightly worse in real terms: -2.5%) – broadly in line with expectations.** The decline was broad-based across regions and sub-sectors, and likely reflects a mix of factors including Omicron's early impacts, a pull-forward in holiday shopping in November due to supply-chain concerns, and disruptions and fuel rationing related to severe flooding in B.C.
- The good news is December's decline will, unexpectedly, be more than recouped next month. **Preliminary data point to a surprise 2.4% gain in January**, which could reflect the end of latter two factors weighing on December sales. It also likely reflects a smaller drag from Omicron relative to previous waves, consistent with lighter restrictions on non-essential retailers. Looking ahead, real-time data suggest retail sales should see another monthly gain in February.

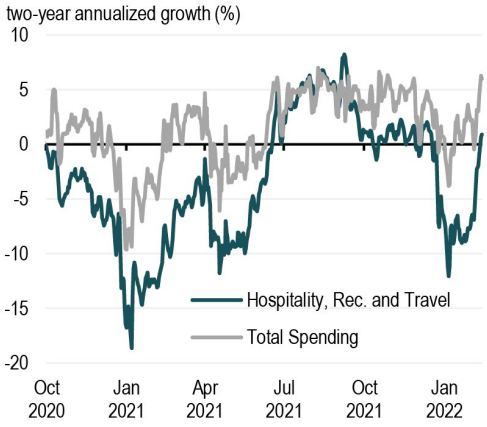
Retail Sales



Real-Time Economic Indicators – February 2022

- After a weak start of the year, **real-time indicators have improved markedly since mid-January** as the Omicron wave crested, confidence improved, and public health restrictions were lifted in several provinces. Measures of consumer activity in close-contact sectors, including restaurant dining and debit card spending, were approaching pre-fifth wave levels as of mid-February. Further improvement is expected in the coming weeks as provinces continue to re-open their economies.
- The **rebound in consumer activity is also leading to improvements in labour market indicators**, with EI applications now close to normal levels after spiking in early January, and online job postings starting to increase again after plateauing last month. Overall, the latest data support our expectation of a solid rebound in employment and hours in February's jobs report.

Debit Card Spending by Segment



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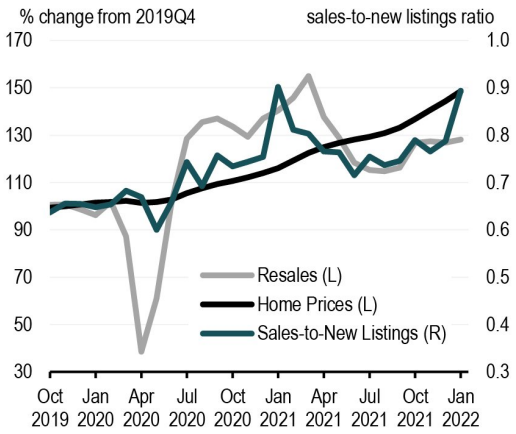
Housing Market – January 2022

- **The housing market heated up in January.** Sales edged up 1% while new listings plunged 11%, pushing the sales-to-new listing ratio to its highest point in a year. Prices continued to soar, posting record monthly (2.9%) and year-over-year (28%) growth rates. Meanwhile, housing starts were weaker than expected in January, easing slightly to 231K pace from 238K in December. Starts are now at a 15-month low, though they remain well above pre-pandemic levels amid strong demand for housing and lack of supply.
- After moderating in mid-2021, the resale market reheated since the summer. While activity could remain strong over the next few months, we **expect higher rates and reduced affordability to gradually cool the market** over the course of 2022. Similarly, a backlog of building permits suggest housing starts will remain elevated in the near term.

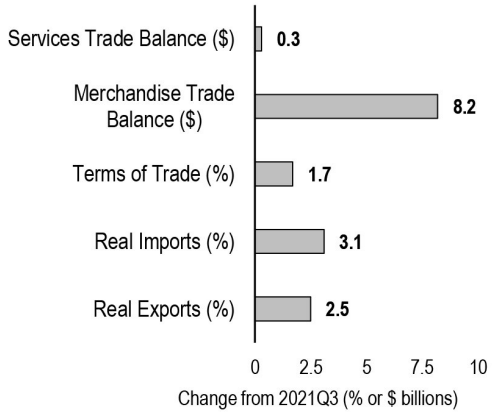
Key Housing Indicators



International Trade – December 2021

- After six consecutive monthly surpluses, the **goods trade balance fell back into deficit in December** due to a surge in imports and a dip in exports that largely reflected lower oil prices. The report capped off what was otherwise a solid quarter, with export volumes up 2.5% on broad-based gains led by a rebound in the auto sector. Import volumes rose 3.1% in Q4, pointing to solid domestic demand, while our terms of trade were up 1.7% driven by rising commodity prices (despite a pullback in December).
- With oil prices on a tear so far in 2022, our **trade balance and terms of trade should bounce-back in January**. We similarly expect the recovery in export volumes to continue in 2022, though it will remain gradual and uneven. Blockades at key border crossings by so-called "Freedom Convoys" may weigh on trade in February, but there should not be long-lasting impacts assuming no more disruptions.

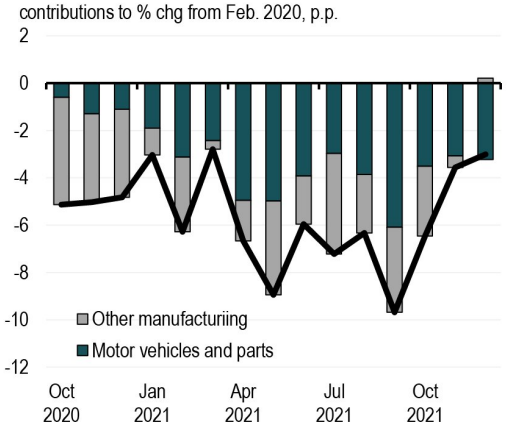
International Trade: 2021Q4 at a Glance



Manufacturing – December 2021

- **Nominal manufacturing sales ticked up 0.7% in December** following strong gains in November and October, despite the B.C. floods reducing sales growth by an estimated 0.3 percentage point. In volume terms, sales grew 0.6% in December and 3.7% in 2021Q4 as a whole. The quarter saw broad-based gains with real sales up in 18 of 21 subsectors, led by a solid rebound in motor vehicles and parts manufacturing as the sector finally had some relief from semiconductor chip shortages.
- **Manufacturing activity could be bumpy over the next few months.** Omicron-related absenteeism and supply-chain disruptions associated with the Ambassador Bridge blockade are expected temporarily weigh on manufacturing, especially in the auto sector, in January and February.

Real Manufacturing Sales



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Economic Indicators Fact Sheet – Canada

	2020	21Q1	21Q2	21Q3	21Q4	Sep -21	Oct-21	Nov -21	Dec -21	Jan-22	Change From Pre-Pandemic
	Year-over-year growth (%)[1]	Period-over-period growth at annualized rates (%)[1]				Period-over-period growth (%)[1]					Change from Feb. 2020[1]
Output											
Real GDP at Basic Prices	-5.1	5.0	-1.1	5.1		0.2	0.8	0.6			+0.2%
Labour market											
Employment (Change, 000s)	-974	67	114	310	289	175	20	156	79	-200	+33K
Unemployment Rate (Level, %)	9.6	8.4	7.9	7.2	6.3	7.0	6.8	6.1	6.0	6.5	+0.8 p.p.
Labour Force Participation Rate (Level, %)	64.1	64.9	64.8	65.2	65.3	65.5	65.3	65.3	65.4	65.0	-0.6 p.p.
Retail Sales											
Nominal	-1.7	8.4	-2.6	11.9	7.1	-0.5	1.5	0.8	-1.8		+9.7%
Real	-2.0	6.2	-6.7	6.0	1.4	-0.8	1.1	0.4	-2.5		+4.6%
Manufacturing Sales											
Nominal	-11.7	27.7	9.9	4.0	25.1	-2.3	4.7	3.1	0.7		+12.6%
Real	-10.3	4.1	-12.5	-2.4	15.6	-3.6	3.6	3.1	0.6		-3.0%
International Merchandise Trade											
Exports, Real	-7.4	3.1	-19.3	7.7	10.6	-3.9	3.0	3.0	-0.7		-4.1%
Imports, Real	-8.0	3.5	0.9	-6.1	13.2	-4.0	5.5	0.6	2.5		+6.0%
Terms of Trade	4.2	-24.7	-18.4	8.4	-6.8	-0.5	-3.5	1.3	1.4		-14.4%
Housing											
Housing Starts[2] (annualized level, 000s)	218	304	279	262	261	251	238	306	238	231	+11.0%
Sales of Existing Homes[2]	12.5	47.8	-41.9	-34.4	46.2	1.3	8.9	0.6	-0.4	1.0	+34.0%
MLS Benchmark Price (year-over-year percent change)	8.7	17.3	24.2	21.9	25.1	21.6	23.5	25.3	26.6	28.0	+21.7 p.p.
Population											
Total Population[3] (year-over-year percent change)	0.9	0.4	0.5	1.1							-0.5 p.p.
Immigration (annualized level, 000s)											
Permanent Admissions[4]	185	282	298	491		542	556	569			+44.9K
International Students[4]	273	275	346	836		856	329	251			+136.2K
Temporary Worker Permit Holders[4]	385	578	485	502		469	382	377			+15.4K
Confidence (change in index points)											
Conference Board Consumer[5]	-31.0	17.6	12.0	7.3	-7.4	3.2	-5.0	-7.0	-0.6	-7.6	-27.5 points
Bloomberg-Nanos Consumer[6]	-6.5	5.7	6.1	-0.8	-4.5	-1.7	0.3	-0.7	-2.0	1.6	+2.4 points
Conference Board Business[3,7]	-17.6	2.6	14.4	-19	-1.8						-2.3 points
CFIB Business Barometer	-4.3	7.4	3.4	-1.8	-3.0	-9.3	2.7	1.7	0.4	-8.3	-6.2 points
Bank of Canada Business Confidence[3,8]	-2.1	1.5	1.2	0.9	1.4						+5.4 points
CPI Inflation (year-over-year percent change)											
Total	0.7	1.4	3.4	4.1	4.7	4.4	4.7	4.7	4.8	5.1	+3.0 p.p.
Core (CPI common)	1.5	1.4	1.8	1.9	2.0	1.9	1.8	2.0	2.1	2.3	+0.5 p.p.
Household Balance Sheet											
Net worth[3] (percent change, non-annualized)	7.1	6.2	2.6	2.0							+23.1%
Debt-to-disposable income ratio[3]	173.4	175.0	176.7	177.2							-3.9 p.p.

Notes
1. Unless otherwise indicated.
2. Pre-pandemic peak is 2019 average level.
3. Pre-pandemic peak is 2019Q4.
4. Change from pre-pandemic peak compares January to July 2021 to January to July 2019. Figures are annualized.
5. Monthly data shows last five surveys. Most recent survey taken Feb. 4, 2022 to Feb. 13, 2022.
6. The Bloomberg Nanos consumer confidence is a weekly survey ending Friday of each week. Monthly data is the average. Most recent value is the average of first two weeks of February 2022 to align with Conference Board survey.
7. The Conference Board's business confidence fourth quarter survey was taken between January 24 and February 7. The Conference Board's report has not been released yet, but data have been made available to us.
8. The Bank of Canada's fourth quarter Business Outlook Survey was taken from November 15 to December 6.

Labour Market Dashboard – Canada

	January 2022	Change from Pre-Pandemic Value	% Change from Pre-Pandemic Value (Feb 2020 = 100%)
Employment (Level, 000)	19,176	+33K	100%
Working less than 50% usual hours (000)	1,558	+746K	192%
Unemployment Rate	6.5%	+0.8 p.p.	114%
Excess Unemployment (000)	--	+184K	--
Long-Term Unemployment Rate	1.3%	+0.4 p.p.	143%
Employment-Population Ratio (15+)	60.8%	-1.1 p.p.	98%
Employment-Population Ratio (15-64)	74.2%	-0.2 p.p.	100%
Labour Force Participation Rate	65.0%	-0.6 p.p.	99%
Total Hours Worked (Level, 000,000)	618	-1.8%	98%
Share of involuntary part-time workers	3.2%	-0.4 p.p.	88%

Real GDP Growth Rate (per cent) – G7 Economies

	2020Q4	2021Q1	2021Q2	2021Q3	Peak to Trough Decline (2019Q4-2020Q2)	Change From Pre-Pandemic Peak (2019Q4-2021Q3)
United States	4.5	6.3	6.7	2.3	-10.1	1.4
Canada	**9.1**	**4.9**	**-3.2**	**5.4**	**-13.0**	**-1.4**
Japan	9.6	-2.9	2.0	-3.6	-7.8	-1.9
France	-4.3	0.6	5.4	13.2	-18.4	0.2
Germany	3.0	-6.6	9.0	6.8	-11.6	-0.8
Italy	-6.6	1.3	11.4	10.9	-17.8	-1.1
United Kingdom	6.1	-5.0	23.6	4.3	-21.6	-1.5

Forecasts for Real GDP Growth Rate (per cent) – Canada

	2021Q4	2022Q1	2021	2022	2023
Bank of Canada MPR – Jan 2022	5.4	5.8	4.6	4.0	3.5
PBO EPC Baseline – Jan 2022			5.9	4.2	1.9
IMF World Economic Outlook Update – Jan 2022			4.7	4.1	2.8
OECD Economic Outlook – Dec 2021			4.8	3.9	2.8
Economic and Fiscal Update 2021 – Dec 2021	5.1	4.8	4.6	4.2	2.8

Forecasts for CPI inflation (y/y, per cent) – Canada

	2021Q4	2022Q1	2021	2022	2023
Bank of Canada MPR – Jan 2022	4.1	4.7	3.4	4.2	2.3
Economic and Fiscal Update 2021 – Dec 2021	4.4	4.2	3.3	3.1	2.3
OECD Economic Outlook – Dec 2021			3.3	3.3	2.1
IMF World Economic Outlook – Oct 2021			3.2	2.6	--
PBO EPC Baseline – Aug 2021			2.9	2.6	2.1

Financial Indicators

	Feb. 28, 2020	March 31, 2020	February 17, 2022	March 31, 2020	February 17, 2022
				Change from Feb. 28, 2020	
Bank of Canada Target Rate (%)	1.75	0.25	0.25	-1.50 p.p.	-1.50 p.p.
3-Month Treasury Bills (%)	1.49	0.26	0.54	-1.23 p.p.	-0.95 p.p.
10-year Government Bonds (%)	1.13	0.70	1.92	-0.44 p.p.	0.79 p.p.
S&P TSX (Canada)	16263	13379	21176	-17.7%	30.2%
S&P 500 (U.S.)	2954	2585	4380	-12.5%	48.3%
WTI Crude Oil ($US/barrel)	44.76	20.51	91.76	-54.2%	105.0%
WCS Crude Oil ($US/barrel)	31.11	5.08	77.47	-83.7%	149.0%